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U. S. DEPARTMENT OF AGRICULTURE
Rural Electrification Administration

RURAL TELEPHONY IN 1966 - A LOOK AT THE BALANCE SHEET

Remarks of Norman M. Clapp, Administrator
Rural Electrification Administration,
Before 1966 Regional Meetings of the
National Telephone Cooperative Association



The regional meetings of your National Telephone Cooperative Association offer us all a very appropriate occasion to take stock of our efforts in expanding the service of rural telephony. It is a time when we can measure the progress we have made as we appraise the problems still ahead of us. It is a time for measuring our growing assets against our program obligations and checking the adequacy of our resources against the magnitude of the challenges we face. In short, it is a time to take a careful look at the current balance

sheet of the rural telephone program.

We really need to look at two balance sheets. One describes the growing physical and financial assets we are developing in rural telephony--and the growing obligations we face as a result of the changing character of rural areas and the increasing demands for higher standards of service.

The other is the balance sheet of human resources and the demands which the continued progress of this program will necessarily impose upon them.

There are 855 REA telephone borrowers, including 229 cooperatives. As of December 31, 1965, the 816 active borrowers reporting to REA showed a combined investment in telephone plant which amounted to more than \$1,167,000,000. This represents an increase of roughly \$110 million over the previous year. This plant included 460,000 route miles of line, 4,165 central offices, and more than 2 million telephones in service.

Revenues of telephone borrowers reporting to REA were \$187.0 million, up nearly \$18.5 million in 1965 over the previous year. By year's end, their assets stood at nearly \$1.1 billion, a gain of \$90.1 million over December 31, 1964. Net worth of all REA telephone borrowers climbed from \$112.3 million to \$133.3 million in the 12-month period, so that their net worth amounted to 12.2 percent of total assets as of January 1, 1966.

Telephone plant investment by cooperatives alone came to a total of \$377.2 million. Cooperatives had 202,000 route miles of line, a gain of 11,000 miles during the year; 1,585 central offices, a gain of 63 during the year; and 563,000 telephones, a gain of 37,000 during the year.

Revenues of the telephone cooperatives reporting to REA were \$47.5 million, up nearly

\$4 million in 1965 over the previous year. By year's end, their assets stood at \$344 million, a gain of \$31 million over December 31, 1964. Their net worth climbed from \$16.9 million to \$21.6 million in the 12-month period, so that the cooperatives showed net worth amounting to 6.3 percent of total assets as of January 1, 1966.

Area Coverage Moves Ahead

But let me point out some significant ratios which emphasize the still present problems of providing rural telephone service on an area coverage basis. The cooperatives are now serving, on the average, slightly more than 2.4 subscribers per route mile of line and are receiving revenues averaging only \$236 per mile of line. These ratios are actually lower than those two years earlier, indicating your continuing efforts in area coverage for the more remote and thinly populated rural areas. These figures are about half the averages of REA's commercial-type borrowers and far below the average of the industry generally.

As a consequence of low subscriber density, cooperatives have a relatively high investment in plant per subscriber. This figure averaged \$746 in 1964 and was up to \$778 in 1965.

Yet despite their built-in handicaps, the cooperatives show gains in operating vigor. The average number of subscribers per cooperative moved up from 2,151 in 1964 to 2,215 in 1965. Average operating revenues per subscriber for the cooperatives edged up from \$97 in 1964 to about \$100 in 1965. Net worth per subscriber also showed improvement--an increase of about \$8 in 1965 against the increase of \$5 for the previous year.

These are indices of improvement and progress which promise a solid foundation for further area coverage and upgrading, if the technical development of the industry and adequate financing continue to be available to you.

On other occasions, I have talked at some length and in some detail about engineering progress and the improvements in materials and design which make it possible to carry service into isolated places, improve service generally, and still keep construction and maintenance costs down.

It is with pride and satisfaction that we in REA have been able to report reduction from year to year in the average construction cost per circuit mile of outside plant for REA-financed systems due to the technological advances we have been able to stimulate in the special field of

rural service. In 1956, the figure was \$241. By the end of 1964, it was about \$98, and we are now happy to report to you that it stands around \$90. This is an asset which goes a long way in offsetting the service handicaps you face.

REA continues, of course, to work with the telecommunication industry and especially with borrowers' systems to push new technological developments which have special promise for the rural sector of the industry.

I will mention just one new study now underway. REA has a committee investigating the use of fine-gauge cable. It will soon report on findings that are bound to have considerable effect on system design. We hope it will enable you to reduce the use of copper, in view of the heavy demand for the metal and the attendant price and delivery problems at the present time. The broader objective, however, is to explore the advantages in optimum use of fine-gauge cables irrespective of the critical copper situation.

It appears that the maximum economic use of fine-gauge cable may be realized when the long-line adapters and repeaters associated with fine-gauge applications can be minimized through common mode operation. As soon as the current studies are

completed, we will pass the results on to you for your consideration.

People Demand Good Service

All these advances, both financial and technological, are growing assets in the balance sheet of rural telephony today, but they must be weighed in the light of the also growing demands for more and better service in rural areas.

Putting it in terms of the balance sheet, we would have to list the demand for service, for better service at reasonable rates, as a liability, because it is something we owe. It is an obligation we undertook when we got into rural telephony. As this Nation's population increases we are going to be called upon to serve more people than ever before, and we will be expected to serve them better than ever before.

The relation of telephones to rural population has a special importance for cooperatives and other telephone systems which have REA loans, or which expect to turn to REA in the future for financing rural service.

Today's population pattern shows most of our cities spilling over into the countryside, as families and businesses are attracted by good transportation, modern dial

telephone service, dependable rural electrification, and other advantages.

Recently we have begun to witness a wholly new element in rural development, the creation of entirely new cities in carefully selected rural locations. These are planned communities, complete with mixed types of housing, with commercial and industrial areas, with schools, churches and recreational facilities.

Only recently The New York Times announced a small city of 12,000 or more population to be built around a new steel mill in a rural location of north central Illinois. Reston in Virginia near Washington, D.C., and Paradise Hills in New Mexico are forerunners of something different which is happening to rural America.

And let us not forget there are still 20 percent of our farms without any kind of telephone service. There are still unserved rural areas waiting for their first telephone service and many more with totally inadequate service judged by modern-day standards.

The rapidity with which we are moving in the direction of single-party service in rural communities can be seen in the rather startling figures on loans for all-single-party service for entire exchange areas. Most of the activity has been in the north

central states, where membership in your Association is quite heavy, but all five REA areas are represented in the totals. By June 30, 1966, REA had made a cumulative total of 75 loans to convert a total of 150 exchanges to all-single-party service. Almost a third of the total represents loans made in the last 3 months of the fiscal year just completed.

During calendar year 1964, REA cooperative-type telephone borrowers upgraded service for 43,000 of their subscribers. In 1965, upgraded service was provided for 53,500 more subscribers by the cooperatives. This is in line with what other telephone systems are achieving, and it is a clear indication of the trend we can expect to continue in your sector of the industry.

The move toward eventual all-single-party service is inexorable, and we have found no reason for changing our forecast that by 1975 more than half of all subscribers on REA-financed lines will have this class of service. We are using a forecast figure of 52 percent, and we are right on schedule.

New Capital Is Required

Meeting the challenges of growth and the demand for higher standards of service

will necessarily require new capital in increasing amounts. Your Federal Government, through the REA program, has in the past been the major source of new capital for rural telephone systems. It has been a major factor in saving an important segment of the independent telephone industry from extinction and an indispensable element in the preservation and improvement of telephone service for vast sections of rural America.

And I might add, it must continue to be a vital and effective partner in rural telephony if the needs of the Nation are to be met in the years immediately ahead.

Since the beginning of the REA telephone program in October of 1949, REA has loaned \$1,272,000,000 for rural telephone facilities. Of this, \$1,066,000,000 has actually been paid out, and \$206 million is still waiting to be advanced. As of September 30, \$121,755,000 had been paid back in addition to \$11,117,000 in advance payments. Interest paid as of that date amounted to \$106,638,000.

In the fiscal year which closed this past June 30, we made loans totaling \$100,961,000, an increase of \$3,987,000 over the loan program of the previous fiscal year.

These are both substantial and impressive sums: more

than \$1 billion invested over the past 16 years, and more than \$100 million in a single year. Yet they are small compared to the needs we anticipate in the future.

We fully expect the requirements of our borrowers for new capital in the coming 15 years will be about \$3 billion, almost three times what has been required from REA in the past 15 years. And we expect the annual requirements for new capital will reach a level of \$225 million by 1975, less than 10 years from now. This is more than double the average annual requirement in the history of the program to date.

We must recognize the urgency of planning and acting now to meet these growing needs of the future.

With all the mounting demands upon the Federal budget, it is totally unrealistic to expect they can or will be met fully out of increased annual authorizations for the present 2 percent direct loan program of REA.

Loan Backlog Reaches New High

Already the backlog of applications on hand is \$250 million, the highest in the history of the program. Even with the increase in loan authorization provided by the

Congress this year, the backlog alone, not to mention the applications still to be received this fiscal year, is more than double the loans we will be able to make.

This is why enactment of the supplemental financing legislation now before Congress is so urgently needed.

This is why your active and unified support of this legislation is so vital not only to the future effectiveness of the rural telephone program but to the future of your own telephone cooperative as well.

The proposed legislation would create a Federal bank, under supervision of the Secretary of Agriculture, for the rural telephone systems. It would provide non-Federal sources of financing to supplement funds appropriated for the 2 percent loan program.

The bank would be capitalized at the outset through stock purchases by both the Federal Government and the borrowers themselves.

The Government's capital investment in the telephone bank would be made over a 15-year period, in the amount of \$20 million each year unless a lesser amount is specified in an appropriation act. This would provide a Government capital subscription to the bank of \$300 million over the 15-year period.

Borrower investment in the bank would accumulate through two devices. First of all, each borrower receiving a loan from the bank would be required to take 5 percent of it in bank stock bearing no cash dividends but eligible to earn capital credits from the bank's operations. Secondly, there would be available on a voluntary purchase basis to all eligible borrowers a special dividend-bearing class of stock, Class C stock.

With these capital resources and the added authority to borrow money in the private money market through the sale of debentures with the back-up of the United States, the bank would make two kinds of loans to rural telephone systems eligible to borrow from REA under the present Act. One type of loan would be an intermediate-rate loan at an interest rate reflecting the current average market yield on marketable securities of the United States having comparable maturities but not to exceed 4 percent. The other type loan would be full market rate loans at an interest rate reflecting the average rate paid on the bank's debentures plus administrative expenses and estimated losses.

Intermediate rate loans would not be available to borrowers which are capable of paying the higher bank rate without jeopardizing their

achievement of the objectives of the rural telephone program.

Borrower Ownership Is Ultimate Goal

Ultimately the Federal stock in the bank would be replaced by the capital of the borrowers themselves in the same manner the Farm Credit banks have been successfully moving toward borrower ownership and control.

One great virtue of the approach to supplemental financing through such a banking device is that it affords a means of multiplying the loan potential of each Federal dollar used. For example, by mixing one interest-free Federal dollar invested in the bank's capital stock with four dollars raised by the bank in the private money market through the sale of 5 percent debentures it is possible to make available five dollars for rural telephone loans at 4 percent without loss to the bank. On this basis, \$20 million of Federal stock subscription each year would make possible \$100 million worth of 4 percent intermediate loans for the program.

I hasten to point out two qualifying factors: First, at this moment it would appear that the bank would have to pay something more than 5

percent on the debentures it sold in the current market, and this would correspondingly reduce the total amount of 4 percent telephone loans which could be supported by the bank's capital structure. Secondly, the amount of intermediate financing provided would in reality be limited by the amount of 4 percent financing borrowers could use without jeopardizing their achievement of the purposes of the rural telephone program.

The majority of the REA-financed rural systems still need the basic 2 percent financing of REA to offset the handicaps of serving in rural areas if they are to move toward full area coverage, rates and service for rural subscribers comparable with what urban subscribers enjoy, and the financial reserves and stability which rural systems must have to meet the challenges of the future.

REA's "price-out" study of the proposed bank, based on what we regard as reasonable projections of loan needs, indicates it could provide loans totaling more than \$1.6 billion over the next 15 years, and end up with a surplus of approximately \$85 million.

Add this loan capability to the present 2 percent basic program and we have the means of meeting the new capital needs of \$3 billion expected in the next 15 years.

Rural Support Urgently Needed

But enactment of legislation of this magnitude does not come to pass unless there is a deep and compelling sense of need and support for it. If that is not felt by the people who are actively associated with rural telephony and its problems, if it is not registered by the rural people whose future service depends upon it, there can be little wonder if Congress fails to show this sense of need and urgency.

This then is the special challenge of the time which will test the human resources of the cooperative rural telephone program, both in management and membership. In this critical public decision people will count, and your cooperatives have an opportunity to play a special role because people play a very distinctive role as consumer-owners in cooperative organizations.

In all the tests of effective action in your cooperative organizations, it is the degree to which the full strength of your people can be brought to bear on a problem that tells the difference between failure and success.

In the balance sheet of human resources your employees and your members are a tremendous asset. REA telephone borrowers had nearly

12,000 employees and more than 1.7 million subscribers at the end of the last calendar year. The 229 telephone co-operatives have nearly 3,000 employees, more than 2,000 directors on their boards, and half a million subscribers who are members and joint owners of the systems which provide them service.

In meeting the problems of the present and the future, in meeting the need for supplemental financing as well as the other needs of day-to-day improvements in management and service, you have in your membership a great untapped potential for constructive action--if the members become personally involved and feel that the problems of the telephone cooperative are their own problems and its successes are their own successes.

Getting them involved, getting them to participate, getting them to understand both the rights and responsibilities of membership in a cooperative is your job--it is a challenge to management and it is every bit as important as building lines.

The full development of membership loyalty and support requires many things of management. At the top of the list are ready communication and a strong information program. You owe it to both your members and your employees to establish and maintain

effective two-way channels of communication and information.

Many years of working with cooperatives show that as a subscriber, the well informed and involved member is more readily persuaded to pay his bill promptly, abide by service rules, understand the reasons for rate changes, consider additional services with an open mind, report trouble conditions accurately and courteously, and show forbearance and understanding in emergencies.

As an owner, the well informed and participating member is more readily persuaded to make helpful and sometimes expense-saving suggestions, to cooperate in keeping costs down, to protect co-op property, to correct misinformation, rumors and false reports, and to attend the annual meeting and make wise decisions.

Experience has taught us that the informed and involved member is the loyal member, and that the loyal member in turn provides the foundation for a strong, vigorous cooperative.

5-Star Program Is Important

With all this clearly in mind, the time has come to give special attention to better utilization of the human resources of your organizations. I urge upon you the importance

of the methods and techniques incorporated in the Five-Star Member Service Program.

More than a third of our telephone cooperative borrowers have held inventory meetings which are an important foundation for strengthening the bond between management and membership. This is the first step.

Better annual meetings, more attractive and informative newsletters, and the establishment of member service committees in the communities you serve are some of the ways to broaden your base of member participation and enlist more effective support from the membership.

As yet only a few cooperatives have undertaken to weld representatives of various interest groups within their membership into active member service committees, but in this device we see great potential as a source for re-

sponsible suggestions, evaluation, and opinion in assisting management. When selected with care and properly instructed on its role in the cooperative, such a committee does not compete in any sense with the board but rather becomes an important aid to the board and manager in maintaining good understanding and effective communications with the membership.

The purpose of all these techniques and devices is the full mobilization of the human resources of the rural telephone program in meeting the growing needs of Rural America. And never was the need for such full mobilization greater than it is today in 1966, for we face a new crisis, a new turning point.

The outcome may well determine whether Rural America will be equal to the pace set by the rest of the Nation, or through apathy or neglect, fall behind.

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